Stoever Glass&Co
30 Wall Street, New York, NY10005

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Dick Larkin
Director of Credit Analysis
Stoever Glass & Co., Inc.
P: (862) 432-8818
E: dlarkin@stoeverglass.com

Every time the topic of federal tax reform is mentioned, it invariably includes a discussion of whether income from municipal bonds should be eliminated. Since the federal income tax was instituted early in the 1900's state and local governments have taken the position that matters established by states are within their powers, and that federal taxation of municipal bond interest was not subject to federal interference. That doctrine held firm into the 1980's, when South Carolina lost a lawsuit that challenged states' rights. Since then, the federal government has been chipping away at tax exemption for municipal bonds.

Many lawmakers view tax-exemption on municipal bonds as merely a tax loophole for the wealthy. While that may have been true in earlier decades, the creation of bond funds has spread to many more middle income taxpayers. In the tax reform debate, the elimination of tax-exemption presents the possibility of hundreds of billions of dollars that could flow into the federal treasury.

What that debate fails to include is the savings of hundreds of billions of dollars to state and local taxpayers because of the lower interest rates for those governments, which are passed on to the same taxpayers. Look around you: you can't see so many things that are built with the proceeds of municipal bonds. The roads we drive on, the water we drink, the schools that educate our children, the bridges we drive over, the airports that we fly from and into, all done at lower interest rates that result from municipal bond tax exemption. So any talk of eliminating municipal bond tax exemption needs to factor in the higher costs of building these facilities that we use every day.

About the Author

***RICHARD P. LARKIN, Stoever Glass & Co., Inc*.**

Richard Larkin, a recognized 40 year industry veteran, has joined SG & Co. as Director of Municipal Credit Analysis. Mr. Larkin began his career in credit rating analysis at Standard & Poor's in 1975. After rising through the ranks in various analytical and management positions, Dick left S&P as its Chief Municipal Rating Officer, responsible for municipal rating policy, practices, governance and criteria. In 1998, Mr. Larkin joined Fitch Ratings as Chairman of its Public Finance Criteria Committee.

"Dick will be a unique resource to Stoever Glass' municipal clients. His knowledge in specific issues and areas of the municipal bond industry will aid our representatives and their clients in making educated decisions, in a sector where this type of research is unique," said Roland Stoever of Stoever Glass.